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Financial Markets

Irving Trust

Irving Trust Company
One Wall Street
New York, NY 10015

Economic Research &
Planning Division

Friday
(Noon)

Oct. 24, 1980

The Federal Reserve has been the target of a barrage of criticism in recent months, as market participants have noted that in the wake of the new reserves-oriented operating procedures introduced on October 6, 1979, both interest rates and money stock growth have been more volatile than before.

The rationale for targeting the long-run growth of the money stock is to use the statistical relationship between the rate of growth of money and nominal income to set the rate of money growth necessary for the desired rate of growth of nominal income. The objective of the Fed's gradual lowering of the targeted long-run rate of monetary growth is to reduce the long-run inflation rate without severely disrupting the pace of real activity.

As is well known, the Federal funds rate operating target used in past years made the Fed miss its money growth targets. In theory, this need not have resulted, but in practice the FOMC was very slow in adjusting its funds rate targets and changed them by relatively minuscule amounts when it did act. This slow reaction reflected the delayed and tentative nature of much economic data, together with the cautious approach of the committee members. The introduction of the reserves-oriented operating procedures was a crucial change: With the FOMC focusing on a reserves growth path consistent with the monetary targets, interest rates are then free to adjust quickly in response to movements in money demand. Thus the introduction of the new procedures a year ago raised hopes that the Fed finally would begin to achieve its long-run monetary targets.

Early this month, a conference sponsored by the Federal Reserve Bank of Boston attempted to assess the need to control the monetary aggregates. The participants--drawn from the financial industry as well as academia and the Fed staff--were sharply divided on almost every issue. Some viewed past shifts of the relationship between money and nominal GNP as a justification for abandoning monetary targets. Others belittled the issue. Some questioned the usefulness of such targets on a theoretical level. And some participants fortunately had concrete suggestions for rectifying various problems created by shifts observed in monetary relationships.

In theory, no intermediate monetary target is needed--one should target the things that "really matter," such as inflation and real economic activity. But a key contributor to past policy errors was the slow response of policymakers, and there monetary/reserves targeting can make a major contribution. Moreover, with the reduction of inflation currently a high priority, the Fed's credibility is linked to the achievement of its long-run targets. The Fed's commitment to those targets implies continued volatile interest rates and probably a less robust recovery than normal. The inflation benefits of the strategy will appear only later. However, our view is that although the reform of October 6, 1979, was scarcely a panacea--and significant problems of defining money remain--policymakers seem, on balance, much better prepared than before to cope with their long-run responsibility for assuring price stability, and that should be encouraging.

William C. Melton

Note: The full text of this letter is available to Telerate subscribers on pages 7250-51 on the Monday morning following the Friday date of the letter.

Irving Trust

Market Yields

	10/24/80	Week Ago	Year Ago
Prime Lending Rate at Irving Trust Company	(Noon)		
Short-term loans to substantial depositors			
with highest credit rating	14.00%	13.50%	15.00%
Effective since	10/20/80		
Discount Rate at Federal Reserve Bank	11.00	11.00	12.00
Federal Funds	13.25	12.63	15.14
Repurchase Agreements	12.50	12.30	12.75
U.S. Treasury Issues			
Bills			
3 months	12.35	11.55	12.30
6 months	12.70	12.13	12.95
1 year	12.74	12.10	12.50
Coupons			
2 years	12.36	11.86	12.11
4 years	12.25	11.69	11.29
7 years	12.04	11.55	11.03
10 years	11.75	11.57	10.85
Long Bond	11.68	11.38	10.30
Negotiable Certificates of Deposit-Secondary Market			
1 month	13.05	12.60	14.25
3 months	13.20	12.70	14.50
6 months	13.25	12.70	14.50
1 year	12.85	12.70	14.25
Banker's Acceptances			
1 month	12.90	12.60	14.05
3 months	13.15	12.40	14.40
6 months	13.44	12.00	14.70
Eurodollar Deposits			
1 month	13.38	13.13	15.31
2 months	13.81	13.31	15.50
3 months	13.88	13.38	15.75
Commercial Paper - Prime Names			
Directly placed by:			
Finance Companies			
1 week	10.00	8.00	12.00
1 month	12.50	12.25	13.90
3 months	12.00	11.50	12.88
Bank Holding Companies			
1 month	12.50	12.25	14.00
Dealer Placed:			
3 months	12.25	11.90	14.25
New AA Corporate Utility Bond	13.63	13.50	11.75
Tax Exempt			
6 month Project Notes	5.90	5.25	6.30
1 year AAA Bond	6.00	5.90	NA
5 year AAA Bond	6.50	6.20	NA
20 year AAA Bond	8.00	8.15	6.85

This information represents prevailing market yields.
It should not be construed as an offering.
All yields are on the offered side of the market.

Cable Address:
"IrvingBank" Telex: I.T.T. 420268 • R.C.A. 232241
W.U.I. 62832 • French 82629